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No. 827

In the Supreme Court of the United States

OCTOBER TERM, 1958

BENJAMIN D. and MADELINE PRENTICE GILBERT,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The first decision of the Tax Court (Pet. 20-33) is reported at 15 T.C.M. 688. The first opinion of the court of appeals (Pet. 34-54) is reported at 248 F. 2d 399. The decision of the Tax Court on remand (Pet. 55-58) is not reported. The final opinion of the court of appeals (Pet. 59-63) is reported at 262 F. 2d 512.

JURISDICTION

The judgment of the court of appeals was entered on January 14, 1959 (Pet. 64). The petition for a writ of certiorari was filed on April 10, 1959. The

jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, on the facts of this case, advances made to a corporation by a stockholder were loans, giving rise to a bad debt deduction, or contributions to capital, giving rise to a capital loss.

STATEMENT

The Tax Court determined a deficiency in taxpayer's [1] income taxes for the calendar year 1948 in the amount of $48,518.65 (Pet. 20-33). The court of appeals remanded the case to the Tax Court for additional findings (Pet. 34-54). The Tax Court made supplemental findings and reaffirmed its original decision (Pet. 55-58). The court of appeals affirmed (Pet. 59-63). The pertinent facts, as found by the Tax Court, are as follows:

In 1946 taxpayer and Albert Borden organized Gilbor, Inc., to engage in the development of various business projects through the acquisition and financing of corporate subsidiaries. The authorized capital stock of the corporation was $120,000, of which 1,000 shares were preferred stock having a par value of $100, and 20,000 shares were common stock with a par value of $1. Borden acquired 4,000 shares of common stock in Gilbor in exchange for $40,000 in cash and the taxpayer acquired 4,000 shares in exchange for assets worth $40,000. Taxpayer was the

[1] Although petitioners filed a joint return, petitioner Benjamin D. Gilbert will be referred to as "taxpayer" since the disputed issue relates solely to his losses.

president and secretary of Gilbor and Borden was treasurer and a director (Pet. 24-25).

At the first meeting of the board of directors of Gilbor, the board authorized expenditures of over $38,000 out of the $42,117.86 in liquid assets then available. At that meeting the corporation obtained advances from its shareholders in order thereafter to conduct business (Pet. 25). Through the years of Gilbor's corporate existence, 1946, 1947 and 1948, it was necessary for the taxpayer and Borden continuously to advance funds to the corporation in order for it to conduct its business (Pet. 27-29).

At the time of the organization of Gilbor and thereafter, the taxpayer and Borden understood that the funds received by Gilbor upon the issuance of its capital stock would not be sufficient to finance the conduct of its business (Pet. 56). At that time it was agreed between the taxpayer and Borden that they would make the advances to Gilbor necessary to the conduct of its business (or furnish collateral to it), and that the advances would be made by the shareholders in proportions equivalent to the proportion of the stock of Gilbor that each shareholder owned (Pet. 56-57). The advances made by the taxpayer and Borden were made by each in proportion to his stock holdings (Pet. 57). Some of those advances were evidenced by notes, but others were not (Pet. 27).

Gilbor was always in serious financial difficulty and the advances were made during a period when interest on prior "loans" was in default, the principal was unpaid, and the corporation was insolvent.

Gilbor used the funds so acquired primarily for working capital and the purchase of capital assets (Pet. 63).

No outsider would have made the necessary advances of funds to Gilbor without adequate security, which security Gilbor could not provide (Pet. 56). The taxpayer's advances were not secured (Pet. 29-30) and were made without regard to any normal creditor safeguards (Pet. 57). The advances were at the risk of the corporation's business with no expectation that they would be repaid unless profits were earned, and the taxpayer made no effort to enforce the obligations (Pet. 57, 63). Gilbor never paid any interest or principal on the obligations (Pet. 27, 29).

On December 16, 1948, Gilbor was dissolved because of its insolvent condition (Pet. 30). Upon the liquidation of Gilbor and its subsidiaries the taxpayer sustained a loss as a result of his advances (Pet. 30-31). The taxpayer deducted the loss on his return as a business bad debt under Section 23(k) of the Internal Revenue Code of 1939.

The Tax Court found that the advances made by the taxpayer to Gilbor constituted contributions to capital rather than debts within the meaning of Section 23(k), and therefore that the loss was deductible as a capital loss under Section 23(g) and not as a bad debt loss (Pet. 57).[2] The court of appeals affirmed (Pet. 59-63).

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[2] That holding made it unnecessary to reach the further question whether the loss, if a bad debt, was deductible as a business or as a non-business bad debt. See Section 23 (k) (1) and (4).

ARGUMENT

The decision of the court below is correct and is not in conflict with any other decision. It affirms the Tax Court's finding that the advances by the taxpayer to Gilbor, made in proportion to his stock interest therein, were contributions to capital and not loans. In so holding, the court below applied the principles established by this Court in *John Kelley Co.* v. *Commissioner* (decided with *Talbot Mills* v. *Commissioner*), 326 U.S. 521, that the question whether an advance by a stockholder to a corporation represents a loan or a capital contribution is essentially one of fact (pp. 526-527) and that "There is no one characteristic, not even exclusion from management, which can be said to be decisive in the determination of whether the obligations are risk investments in the corporations or debts" (p. 530).[3] The form of the transactions is not deter-

[3] Hence, the taxpayer's contention (Pet. 8-9, 14-15), that it was necessary for the courts below to find an imbalance in the debt-equity ratio of Gilbor and make a specific finding with respect to the taxpayer's intent, in order to find that the advances constituted risk investments, is without merit. The question must be decided in the light of all the facts and no one factor is controlling. Accordingly, even where the debt structure of the corporation is not excessive, or where advances are not in proportion to stock holdings, it has been held that the cumulative effect of other circumstances justifies a finding that advances constitute risk capital. *John Kelley Co.* v. *Commissioner*, 326 U. S. 521, 525-530; *Reed* v. *Commissioner*, 212 F. 2d 334, 335 (C.A. 2); *Gooding Amusement Co.* v. *Commissioner*, 23 T.C. 408, 419, affirmed, 236 F. 2d 159 (C.A. 6), certiorari denied, 352 U. S. 1031; *Dittmar* v. *Commissioner*, 23 T.C. 789, 796. Moreover, the courts below did find that the taxpayer understood that

minative of the question, and the taxpayer has the burden of proving by a preponderance of the evidence that the advances were not risk investments. *John Kelley Co.* v. *Commissioner*, *supra*, p. 530; *Arlington Park Jockey Club* v. *Sauber*, 262 F. 2d 902 (C.A. 7); *Reed* v. *Commissioner*, 242 F. 2d 334, 335 (C.A. 2); *Matthiessen* v. *Commissioner*, 194 F. 2d 659, 661 (C.A. 2); *Schnitzer* v. *Commissioner*, 13 T.C. 43, 60, affirmed *per curiam*, 183 F. 2d 70 (C.A. 9), certiorari denied, 340 U.S. 911; *Gregg Co. of Delaware* v. *Commissioner*, 239 F. 2d 498, 502 (C.A. 2), certiorari denied, 353 U.S. 946; *Gooding Amusement Co.* v. *Commissioner*, 236 F. 2d 159 (C.A. 6), certiorari denied, 352 U.S. 1031; see *Rowan* v. *United States*, 219 F. 2d 51, 55 (C.A. 5).

The evidence recited in detail by both courts below fully warrants the Tax Court's conclusion that the advances in question were, in fact, risk investments. That the taxpayer and the other shareholder of Gilbor knew that the funds originally invested in that corporation would be insufficient, that the shareholders agreed to advance the funds needed for working capital in proportion to their ownership of stock, that the advances were in fact made by the shareholders in proportion to stock interests, that the advances were used for working capital and to purchase capital assets, that Gilbor never paid interest or

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his advances were essentially in the nature of contributions to capital (Pet. 56-57, 60-61, 63). The court below did not hold that intent is irrelevant; it merely held (Pet. 62), citing *Gregory* v. *Helvering*, 293 U.S. 465, that the taxpayer's motive is not determinative.

principal on the obligations, that the obligations were not enforced, and that the advances were at the risk of the corporate business with no expectation of repayment unless that business was successful, are some of the factors in the record which in and of themselves furnish substantial evidentiary support for the Tax Court's finding. The holding of the court below (Pet. 62-63), based upon its review of all the facts, that the advances were contributions to capital and that the taxpayer did not show the Tax Court's finding to be erroneous, is therefore clearly correct. Under the settled rule of this Court, since the question is essentially factual,[4] the concurrent findings of both courts below should be considered final here. *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, 51; *Comstock* v. *Group of Investors*, 335 U.S. 211, 213-214.

That the court below referred to the true intent of the parties in terms of "substantial economic reality" (Pet. 62) does not, as the taxpayer asserts, present any substantial legal question. As the court pointed out (Pet. 62), that term is merely a way of expressing the applicable principle that the decision as to whether advances to a corporation are in substance capital contributions or loans depends upon all the facts in the particular case, no one of them

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[4] *John Kelley Co.* v. *Commissioner*, 326 U. S. 521, 526, 530; *Gooding Amusement Co.* v. *Commissioner*, 236 F. 2d 159 (C.A. 6), certiorari denied, 352 U.S. 1031; *Root* v. *Commissioner*, 220 F. 2d 240, 242 (C.A. 9); *Matthiessen* v. *Commissioner*, 194 F. 2d 659, 661 (C.A. 2); *Schnitzer* v. *Commissioner*, 13 T.C. 43, 60, affirmed *per curiam*, 183 F. 2d 70 (C.A. 9), certiorari denied, 340 U. S. 911.

being determinative. Since determination of the question depends upon the particular record made before the trial court, the taxpayer's suggestion of conflict (Pet. 10-12) with *Rowan* v. *United States*, 219 F. 2d 51 (C.A. 5); *Maloney* v. *Spencer*, 172 F. 2d 638 (C.A. 9); and *Van Clief* v. *Helvering*, 135 F. 2d 254 (C.A.D.C.), is plainly without merit.[5]

[5] In *Rowan* the only evidence showed that the advances there in question were loans, but the Fifth Circuit indicated (219 F.2d at 55) that its decision that the advances were loans might have been different if there were facts in the record similar to those which we find in the case at bar. In *Maloney* the Ninth Circuit merely held that the trial court's finding that advances made to a corporation were loans was not clearly erroneous. Compare that court's opposite decision in *Schnitzer* v. *Commissioner*, 13 T.C. 43, affirmed *per curiam*, 183 F. 2d 70, certiorari denied, 340 U. S. 911, on facts closer to the present case. In *Van Clief* which was decided before this Court's decision in *John Kelley Co.* v. *Commissioner*, 326 U.S. 521, the court, on facts different from those in the present case, merely remanded the case to the trial court for additional evidence with respect to the nature of the advances and obligations arising therefrom.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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